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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 332

FRANCIS I. DuPONT, EDMUND DuPONT, RHETT DuPONT, E. PAUL DuPONT, WILLIAM A. FINE, ARTHUR F. SHETTLE AND WILLIAM A. WHITAKER, CO-PARTNERS, TRADING UNDER THE FIRM NAME AND STYLE OF FRANCIS I. DuPONT & COMPANY,

Petitioners,

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

IRVING MARIASH,
I. MAURICE WORMSER,
Counsel for Petitioners.

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Statute:

Revenue Act of 1926, Title 8, Section 800, Schedule A-4 [26 U. S.

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Petitioners,

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Your petitioners respectfully pray that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above entitled case on June 8, 1936, affirming the judgment of the United States District Court for the Southern District of New York.

Opinions of the Courts Below.

The opinion of the District Court, though not reported, is in full in the Record (R. 35). The opinion of the Circuit Court (R. 49) is reported in 83 F. (2d) 951.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered June 8, 1936 (R. 53). The jurisdiction of this Court is invoked under the provisions of Section 240 of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

1. Where a customer transfers his account from one broker to another, is the transfer taxed as a sale under Revenue Act of 1926, Title 8, Section 800, Schedule A-4 (26 U. S. C. A. 900, 903), merely because the parties used printed sheets designated "bought" and "sold"?

2. Does the exclusive fact that certain printed forms were used, alone determine the taxable status, without any relation whatsoever to the legislative intent to tax well-defined transactions (sales) through the instrumentality of documents used in carrying them out?

3. Which of the two diametrically contradictory constructions of the statute here involved is correct: *United States* v. *Uhlmann Grain Co.*, U. S. C. C. A., Seventh Circuit, June 18, 1936, holding no tax due, or the case at bar holding the tax to be due?

Statement of Facts.

The facts are undisputed, both petitioners and respondent relying on the affidavits of the same persons. They are correctly outlined in the opinion of the District Court (R. 35). They are not correctly set forth in the opinion of the Circuit Court, as shown hereafter. The review of the facts in the latter opinion is not supported by the record.

Petitioners are brokers on the New York Cotton Exchange. A customer, J. P. Abney, and his associates, purchased 24,100 bales of cotton futures contracts. He car-

ried them with petitioners' brokerage house, that is, he was "long" that number of bales. At the request of the brokers the customer transferred his account to another broker, Messrs. Fenner & Beane. *The contracts still remained in the name of the same customer and were still owned by the same customer before and after the transfer from the brokerage house of du Pont to the brokerage house of Fenner & Beane.*

The Cotton Exchange uses only one set of forms for convenience. Whether an actual sale takes place or whether there is merely a transfer of an account from one broker to another, the transaction is cleared by reporting it on "sold" sheets from du Pont and "bought" sheets from Fenner & Beane. These same documents, therefore, in some instances are evidence of a sale and in some instances are merely evidence of a transfer of brokers.

Although in fact there was no real sale involved, but merely the transfer of Abney's account from du Pont to Fenner & Beane, at the end of the month du Pont's stamp clerk erroneously and as a matter of routine affixed stamp taxes on the monthly reports to cover this transaction.

The good faith of the parties is conceded by the Government, and in fact a tax was ultimately paid when the cotton contracts were really sold by Abney. The denial of the refund results in two taxes having been paid, although the cotton was sold only once.

Specification of Errors.

The court below erred:

1. In holding that the transfer involved a contract of sale.

2. In holding that the petitioners were not released after the transfer and still remained obligated to receive delivery.

3. In rejecting the testimony of all of the witnesses as to the nature of the transaction as mere expressions of opinion.

4. In holding the transaction was not within the exception covering "transferred" sales.

5. In holding that the transaction was taxable.

6. In affirming the judgment of the District Court.

Reasons for Granting the Writ.

1. The opinion in this case has been sharply criticized by a later opinion in the Circuit Court of Appeals for the Seventh Circuit, *United States* v. *Uhlmann Grain Co.*, U. S. C. C. A., Seventh Circuit, June 18, 1936. That case exactly parallels the case at bar. Brokers on the Board of Trade in Chicago transferred accounts from one to another as did the brokers on the Cotton Exchange herein. As between the brokers, they understood that it was not a real sale, but simply a transfer of the accounts for purposes of their own. As far as the Board of Trade was involved, it was recorded as a sale, exactly as in the case at bar where the Cotton Exchange records apparently showed it to be a sale.

Likewise parallel, the transaction in that case did not go through the "pit" or floor of the exchange, but was done as a private office transaction. The reason for this was the same in both cases. If it went through the "pit" or floor, every other broker might have bid on it and the price would have been the current price on the floor. Since they merely intended to transfer the accounts, they did so, not at the current price, but at the same price at which it was carried on their books. In both cases, had there been a bona fide sale, the Board of Trade and Cotton Exchange regulations would have absolutely required it to go on the floor, but since it was not a bona fide sale, a private transaction was

proper. In both cases, the records of the brokers show the true nature of the transaction, although the records of the Clearing House and Board of Trade made it appear like a sale. The relationship of the parties, their respective rights and liabilities, and the usages of the Exchange were parallel.

The decision in the case at bar was before the court in the Seventh Circuit when it rendered its opinion and it frankly disagreed. The arguments raised by the Government counsel, though the same as in the case at bar, were rejected by that court. Likewise, the reasoning of the Circuit Court in the case at bar as to the assumption of liability by the brokers was held immaterial in that decision. The court candidly recognized that the transaction was not the usual sale, was not put through on the floor of the Exchange, was brought about by an office communication rather than a trade and that its correct nature was shown by the records of the brokers, although the official records of the Clearing House made it appear like a sale.

After reviewing the facts, the Court said:

> "There is a substantial difference between the records of an actual, completed sale which all parties agree is subject to the tax, and those of such a transaction as is here sought to be taxed, although both show up on the final records of the clearing house as sales. Appellant argues that because the transfer is recorded by the clearing house as a sale, with no indication on its records of its accommodation, character, and because the Board of Trade will recognize such transfer only on the basis of the assumption by the accommodation party of liability to fulfill the contract in case of default by the accommodated one, it must be considered a sale, agreement of sale or agreement to sell, subject to the tax. It apparently considers immaterial the fact that the transaction was brought about by the irregular method of an office or telephone communica-

tion, rather than in the pit. It argues that the government should be able to tax transactions according to the official records of the clearing house without having to refer to private agreements which negative their effect, or having to inspect subordinate records in order to determine how the transaction took place."

The Court then having its attention called to the decision in the case at bar commented upon it as follows, after brushing aside immaterial distinctions on the facts:

> "The decision of the New York case does not, however, rest on this distinction. Instead, the court there emphasizes the form of the transaction, 'Although the purpose of the transaction was to transfer a customer's account from one brokerage firm to another, the mechanics of doing this involved a contract of sale for future delivery made by the plaintiffs with the substitute broker. * * *' *The same might be said as to the transaction here involved, if we chose to be governed by the mechanics rather than the purpose of the transfers. We think, however, that the character of the transaction is not conclusively determined by the nature of the bookkeeping entry used in bringing it about. We agree with the finding of the District Court that the transactions herein described were not sales, agreements of sale, or agreements to sell, hence were not properly taxed as such.*"

We respectfully urge that the realistic approach of the Seventh Circuit Court with full recognition of the actual facts is much to be preferred to sustaining a tax upon a fiction conceived in inaccurate bookkeeping and given judicial recognition by refusing to see the true facts when they are undisputedly disclosed. Reasoning such as applied by the Court in the case at bar gives origin to the unhappy connotation attached to the words "legalistic reasoning." The tendency of modern judicial thought is not to unnecessarily differentiate the logic of the forum from the logic of the market place.

2. The Circuit Court opinion herein contradicts the reasoning of the District Court, *each affirming the judgment on inconsistent grounds.*

The District Court found that "actually there was no sale" and further found "It does not matter that by looking at facts outside the instrument we may perceive that actually there was no sale, but simply a change of brokers." The District Court based its opinion squarely upon the form of the instrument, frankly admitting that there was no sale.

The Circuit Court likewise supports the tax, although finding by strained reasoning that *there was a sale*, thus admitting by inference that no tax would levy unless there was a real sale. And the Circuit Court in the *Uhlmann* case clearly refutes the reasoning that a real sale resulted.

3. The decision is in conflict with the decisions in *Union Trust Co.* v. *Heiner*, 26 F. (2d) 391; *Dean* v. *Caldwell*, 9 F. Supp. 177; *Field Glore* v. *United States* (Standard Fed. Tax Service, Vol. 3-A, 1935, pp. 9803-9805); *A. B. Leach* v. *United States*, N. D. Ill., July 16, 1935; *National Bond & Share Corp.* v. *Hoey*, D. C., S. D. N. Y., October 29, 1935; and *United States* v. *Uhlmann*, U. S. C. C. A., Seventh Circuit, June 18, 1936.

The Circuit Court for the Second Circuit has expressly repudiated the *Union Trust* v. *Heiner* decision *in spite of its having been followed so often by other courts.* In *Founders* v. *Hoey*, U. S. C. C. A., Second Circuit, July 6, 1936, it said:

> "The decision (*Union Trust* v. *Heiner*) therefore proceeded on an indefensible theory."

The conflict between the Second and Seventh Circuits on this very important point of law, and the lack of harmony in the various District Courts require clarification by this Court. The latest Supreme Court decision is *United States*

v. *Isham*, 17 Wall. 496 (1873), 21 L. Ed. 728, 84 U. S. 496, decided over 60 years ago and prior to the origin of these conflicts.

4. The Court disregarded the well recognized maxim that doubts as to the propriety of the tax should be resolved in favor of the taxpayer. *United States* v. *Isham*, 17 Wall. 496 (1873), 21 L. Ed. 728, 84 U. S. 496, laid down the following as a cardinal principle:

> "If there is a doubt as to the liability of an instrument to taxation, the construction is in favor of the exemption."

The doubt on the construction of this taxing statute is so great that several District Court opinions conflict and the Court of Appeals in the Second and Seventh Circuits are in disagreement (see *United States* v. *Uhlmann*, *supra*). Such a genuine doubt in the minds of eminent jurists is alone sufficient to warrant a determination in favor of the taxpayer.

5. There was no "sale" when Abney's account was transferred from one broker to another. Though the Clearing House forms seemed to indicate a sale, an examination of the true transaction and the records thereof clearly shows there was no sale. The parallel analysis made in *United States* v. *Uhlmann*, *supra*, exactly fits the facts at bar. There was no transfer of title, there was no buyer and seller. Title always remained in Abney, both before and after the transfer. Furthermore had there been a real sale, it must necessarily have been conducted on the floor of the Exchange in accordance with its rules. This transaction never went through the floor or "pit," nor was the general membership of the Exchange permitted to bid on the transaction as would have been absolutely required had there been a real sale.

6. Where there is a real transaction contemplated by the taxing statute, form generally determines the documentary tax. But where there is no real taxable transaction, a form is a mere simulacrum. This is best expressed in *United States* v. *Uhlmann, supra.*

> "The same might be said as to the transaction here involved, if we chose to be governed by the mechanics rather than the purpose of the transfers. We think, however, that the character of the transaction is not conclusively determined by the nature of the book-keeping entry used in bringing it about. We agree with the finding of the District Court that the transactions herein described were not sales, agreements of sale, or agreements to sell, hence were not properly taxed as such."

In *Merchants Warehouse* v. *McClain,* 112 Fed. 787, aff'd 115 Fed. 295, the Court said:

> "I do not understand, however, from either of these cases, that the instrument is to be entirely divorced from the circumstances under which it is given; and indeed, I do not well see how it could be, since *we must to some extent, look to the connection, to know just what it is with which we are dealing.*"

In *National Bond & Share Corp.* v. *Hoey,* D. C., S. D. N. Y., October 29, 1935, Judge Julian W. Mack in the same District disagreed with, and declined to follow, a previous decision by Judge Goddard finding that form alone controls.

Other cases supporting our conclusions are: *Union Trust Co.* v. *Heiner,* 26 F. (2d) 391; *Dean* v. *Caldwell,* 9 F. Supp. 177; *Field Glore* v. *United States* (Standard Fed. Tax Service, Vol. 3-A, 1935, pp. 9803-9805); *A. B. Leach* v. *United States,* N. D. Ill., July 16, 1935.

Though there was no sale, a tax was levied because a form was used for the convenience of bookkeeping and rec-

ord. The form is the instrumentality through which a *real* sale is taxed. But the stamps are required only on documents used in connection with transactions contemplated by the taxing statute. Though a document be of a form customarily used in a taxable transaction, *if in truth it was erroneously or unwisely used in connection with a non-taxable transaction,* no tax is assessable. The document is only the means through which Congress reaches the real transaction. Where there is no taxable transaction the empty form ceases to be important.

7. The statute expressly exempts "transferred or scratch sales." The record describes a transferred sale as a transfer of a contract from broker to broker without commission being charged (R. 96, 52, 48). Treasury regulation 71, Articles 4A and 125 (3) (c) describe it as a purchase and sale at the same session of the Exchange, at the same price and on the same day for the account of the same person. Here the purchase and sale were made by Fenner & Beane and du Pont on the same Exchange, on the same day at the same price and for the account of the same customer, Abney.

The Court was unwarranted in rejecting the testimony of all the witnesses in this respect by merely calling them "opinions." The "opinions" of qualified experts must be relied upon by the Court where they are given honestly and in good faith, when the Court has no knowledge of its own on the subject.

8. Contrary to the facts and contrary to the record, the Circuit Court of Appeals found that the transaction did not release du Pont and that du Pont still remained obligated on the contracts transferred to Fenner & Beane. Nothing in the record supports this finding. The Circuit Court sweeps aside the statements in the record to the contrary

by saying that they are "merely expressions of opinion by the affiants." The affiants happen to be all and the only persons who know the true nature of the transaction. They include two experienced brokers and the Secretaries of the Exchange and of the Clearing House. Any one conversant with commodity exchanges knows that on a transfer of contracts, the first broker is completely out of the picture. The Court apparently was thinking of a "hedge," but a "hedge" is done on the open floor by *viva voce* bidding and all traders on the floor have an opportunity to bid on the purchase and sale. This transaction was a transfer which did not go on the open floor, was not a "hedge" and did not leave du Pont with remaining liability upon the contracts. It was the Circuit Court's complete misapprehension of this process that induced its conclusions.

WHEREFORE your petitioners respectfully pray that a writ of certiorari issue under the seal of this Court to review the decree of the Circuit Court of Appeals for the Second Circuit in the above case, and that said decree be reversed.

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